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Transcript Exhibit(s)

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

Docket #(s): T-02063A-12-0473

Exhibit #: A1, A2

Arizona Corporation Commission

DOCKETED

APR - 5 2013

DOCKETED BY	<u>nr</u>
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ORIGINAL

NEW APPLICATION

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP
BRENDA BURNS

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ALL CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

NOV 23 2012

DOCKETED BY

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IN THE MATTER OF THE APPLICATION OF
ARIZONA TELEPHONE COMPANY, AN
ARIZONA CORPORATION, FOR A HEARING
TO DETERMINE THE EARNINGS OF THE
COMPANY, THE FAIR VALUE OF THE
COMPANY FOR RATEMAKING PURPOSES,
AND TO INCREASE RESIDENTIAL RATES AS
NECESSARY TO COMPENSATE FOR THE
RATE IMPACTS OF THE FCC'S USF/ICC
TRANSFORMATION ORDER

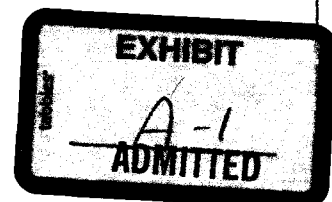
DOCKET NO.

T-0263A-12-0473

1 Arizona Telephone Company ("Arizona Telephone"), an Arizona corporation, hereby
2 applies pursuant to A.R.S. § 40-250 and the Commission's Rule R 14-2-103 for a determination
3 of Arizona Telephone's earnings and the fair value of its investment and requests that its
4 residential rates be increased as necessary to compensate for the rate impacts of the Federal
5 Communication Commission's November 18, 2011, USF/ICC Transformation Order ("USF/ICC
6 Order").

7 **I. BACKGROUND**

8 On November 18, 2011, the Federal Communications Commission issued the USF/ICC
9 Order. The USF/ICC Order transitions the outdated federal universal service programs and most
10 inter-carrier compensation systems into a new Connect America Fund ("CAF"). The FCC's
11 press release characterized the USF/ICC Order as "the most significant policy step ever taken to
12 connect all Americans to broadband."



1 The USF/ICC Order will reduce inter-carrier compensation rates to zero by July 1, 2020,
2 for rate of return companies, with limited recovery from customers and partial recovery from the
3 CAF. The recovery from the CAF will phase out over time at 5% annually.

4 Arizona Telephone is a small rate-of-return regulated Incumbent Local Exchange Carrier
5 ("ILEC"). Of particular importance to Arizona Telephone and other rural ILECs, the USF/ICC
6 Order adds new rules that will reduce federal high-cost loop support to carriers by the amount
7 their flat-rate residential local service rates fall below a specified annual urban rate floor.¹ The
8 rate floor includes, if any, state subscriber line charges, state universal service fees, and
9 mandatory extended area service charges. The FCC's order establishes local residential rate
10 floors of \$10.00 as of June 1, 2012, and \$14.00 as of June 1, 2013, with the floor thereafter being
11 determined annually by the FCC's Wireline Competition Bureau, based on a nationwide
12 average.²

13 Federal and state support funding are vital to a robust telecommunications network in
14 high cost areas. To maintain federal loop support, Arizona Telephone and other rural ILECs
15 must increase local rates to the FCC-mandated residential rate floors. Otherwise, the amount of
16 federal support funds will be reduced dollar-for-dollar for each customer by the difference
17 between the existing local rate and the new rate floor. If local rates are not increased, the new
18 FCC rules will reduce funds coming to the state of Arizona and negatively impact customers
19 living in high-cost areas in the state.

20 Low customer density makes Arizona Telephone dependent on high-cost federal support
21 mechanisms. It is important that the company be allowed to increase local rates, to the FCC
22 determined annual rate floors, in order to maintain its existing federal support. Therefore,
23 Arizona Telephone requests the Commission to approve local rate increases to the \$14 rate floor
24 established by the FCC's order.

¹ 41 C.F.R. § 54.318.

² USF/ICC Order paragraph 236 states the most recently available nationwide average local rate from 2008 was \$15.62.

1 **II. ARIZONA TELEPHONE**

2 Arizona Telephone Company is a corporation duly organized and existing under and by
3 virtue of the laws of the State of Arizona. Arizona Telephone is authorized to engage in and is
4 now engaged in the conduct of a general communications business within the State of Arizona.

5 **III. SUMMARY OF REQUEST**

6 This application is made pursuant to the provisions of A.R.S. §§ 40-250 and 40-367, and
7 Commission Rule R14-2-103. The Commission last considered Arizona Telephone's rates in
8 Docket No. T-02063A-12-0302, which resulted in Commission Decision 73575 issued on
9 November 21, 2012. Decision No. 73575 authorized Arizona Telephone to raise its residential
10 one-party rates to \$10.00/month, effective December 1, 2012. However, Arizona Telephone
11 will lose federal support funds if its local rates are not increased to \$14.00 by June 1, 2013. The
12 rate floor for 2014 and thereafter will be determined by an annual FCC survey.

13 Arizona Telephone is aware that many parties, including the Commission, have appealed
14 the USF/ICC Order. However, in the meantime, Arizona Telephone and other rural ILECS must
15 comply with all provisions of the USF/ICC Order and will remain subject to the increased local
16 residential rate floors and the corresponding losses of federal support funds.

17 Arizona Telephone's loss of federal support funds would be particularly difficult to bear.
18 As the attached schedules demonstrate, Arizona Telephone's return on investment will still be
19 negative, even after the December 1, 2012, rate increase is effective. Put another way, Arizona
20 Telephone's jurisdictional earnings are negative. Losing federal support funds will only drive
21 earnings deeper into the red.

22 In connection with this application, Arizona Telephone has filed exhibits which include a
23 schedule of the specific rate changes requested and the impact of the revenue generated on the
24 company's financial position. Arizona Telephone asks that the Commission determine the fair
25 value of the company's investments for ratemaking purposes and stipulates to use original cost
26 less depreciation for those purposes. Because the next opportunity to affect federal support

1 funds is June 1, 2013, Arizona Telephone further asks that the Commission set new rates at or
2 above the \$14.00 floor to be effective no later than June 1, 2013.

3 To facilitate processing of this application, Arizona Telephone asks that the Commission
4 waive any provisions of Commission Rule R14-2-103 not required by the Arizona Constitution
5 and laws.

6 Respectfully submitted on November 23, 2012.


7
8 
9

10 Craig A. Marks
11 Craig A. Marks, PLC
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14 (480) 367-1956 (Direct)
15 (480) 367-1956 (Fax)
16 Craig.Marks@azbar.org
17 Attorney for Arizona Telephone Company

Original and 13 copies filed
on November 23, 2012, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

By:


Craig A. Marks

Arizona Telephone Company

Streamlined filing to support residential rate increase due to FCC
floor implementation and resulting HCL loss.

October 31, 2012

Arizona Telephone Company

October 31, 2012

Index

	<u>Page</u>
Adjusted Results Twelve Months Ending June 30, 2012	1
Adjustments	2
Year 1 FCC Order ICC Impact	4
Rate Base	5
Working Capital	6
Rate Design	7

Arizona Telephone Company

October 31, 2012

REGULATED RESULTS OF OPERATIONS FOR TWELVE MONTHS ENDING JUNE 30, 2012
REFLECTS CHANGES EFFECTIVE WITH ARC AND CAF IMPLEMENTATION – YEAR 1

	TOTAL TELEPHONE OPERATIONS	ADJUSTMENTS	Ref	ADJUSTED RESULTS	INTERSTATE	INTRASTATE
	(a)	(b)	(c)	(d)	(e)	(f)
1 Local	581,156	-5,125 # 8		576,031	0	576,031
2 Universal Service Fund (USF-HCL) and Safety Net Additive (SN/	166,176	-60,116 #6.7		106,060	0	106,060
3 Access Revenues	2,133,629	-50,630 #5.8		2,082,999	1,700,623	382,376
4 Billing & Collecting	24,820			24,820	3,905	20,915
5 Other Misc., Uncollectibles	59,033			59,033	23,397	35,636
6 Total Operating Revenues	2,964,814	-115,871		2,848,943	1,727,925	1,121,018
7 Plant Specific Expenses	741,924	-15,813 #10.13		726,111	351,314	374,797
8 Plant Nonspecific Expenses	407,521	-3,311 #6.12,13		404,210	202,970	201,240
9 Depreciation & Amortization Expenses	1,223,534	1,980 #13		1,225,514	578,743	646,771
10 Customer Operations Expenses	341,596	180 #11,13		341,776	101,401	240,375
11 Corporate Operations Expenses	513,913	660 #13		514,573	183,480	331,093
12 Other Operating Taxes and (Income)	132,415	684 #6.13		133,099	61,895	71,204
13 Nonregulated Adjustment (Part 69 WB)		-5,676 #13		-5,676	-5,676	0
14 Total Operating Expenses	3,360,803	-21,296		3,339,607	1,474,127	1,865,480
15 OPERATING RETURN BEFORE TAXES	-396,089	-94,576		-490,664	253,798	-744,462
16 State Income Taxes (SIT) (6.97%)	23,197	-57,366 #14		-34,169	17,690	-51,859
17 Federal Income Taxes (FIT) (35%)	-131,467	-28,286 #14		-159,753	82,636	-242,401
18 Total Operating Income Taxes	-108,270	-85,692		-193,862	100,328	-294,290
19 Total Expenses and Income Taxes	3,252,633	-106,988		3,145,645	1,674,455	1,571,190
20 Net Operating Income	-287,819	-8,883		-296,702	153,470	-450,172
21 Total Year-End Rate Base	3,873,823	0		3,873,823	1,478,798	2,395,025
22 Return on Rate Base (Ln 20 / Ln 21)						-16.8%
23 Estimated Revenue from Local Rate Increase						94,762
24 State Income Taxes (SIT) (6.97%)						6,604
25 Federal Income Taxes (FIT) (35%)						30,852
26 Increase in Net Operating Income						57,298
27 Net Operating Income After Increase (Ln 20 + Ln 26)						-392,876
28 Return on Rate Base After Increase (Ln27 / Ln21)						-16.4%

ASSUMPTIONS
Used 2011 Cost Study run dated 04/30/2012 for Part 35 separately
Separated results based upon frozen 2000 traffic factors
Separated results based upon 6/30/2012 financials, interstate rules, adjusted for Part 64 activities
Working Capital included for all jurisdictions

Arizona Telephone Company
Adjustments to Revenues and Expenses

Ref	Account	Description	Debit	Credit
1.	5082200	Access Revenues	482	
	5083000	Access Revenues	243	
	Exclude			725
	To remove prior period (2008) interstate revenue requirement adj.			
2.	5082200	Access Revenues	6,166	
	5083000	Access Revenues	4,168	
	Exclude			10,334
	To remove prior period (2009) interstate revenue requirement adj.			
3.	5082100	Access Revenues	41,948	
	5082200	Access Revenues		53,221
	5083000	Access Revenues	18,790	
	Exclude			7,517
	To remove prior period (2010) interstate cost study true-up.			
4.	5082200	Access Revenues		8,114
	5083000	Access Revenues		4,308
	Exclude		12,422	
	To remove prior period (2010) interstate revenue requirement adj.			
5.	Not Used			
6.	5082110	Universal Service Fund	59,579	
	PPA			59,579
	To adjust for Federal HCL and SN projected change for 2012.			
7.	5082110	Universal Service Fund	537	
	PPA			537
	To remove prior period HCL revenues.			
8.	5001000	Local Revenues	5,125	
	5082200	Access Revenues	30,520	
	5084220	Access Revenues	13,956	
	6540010	Plant Nonspecific Exp		1,638
	Exclude			47,963
	Year 1 FCC Order ICC intrastate and interstate revenue and expense 5% reductions.			
9.	PPA		204	
	7240300	Other Operating Taxes		204
	To remove prior period property tax true-ups.			
10.	6423004	Plant Specific Exp		17,433
	Exclude		17,433	
	To remove one-time write-off of court ordered restitution for damage to TDS cable not received.			

Arizona Telephone Company
Adjustments to Revenues and Expenses

Ref	Account	Description	Debit	Credit
11.	Not Used			
12.	6540011	Plant Nonspecific Exp		2,021
	PPA		2,021	
	To remove prior period (2009 & 2010) 499A interstate expense adjustments and DSL FUSC refund.			
13.	6112004	Plant Specific Exp	-	
	6121004	Plant Specific Exp	180	
	6232004	Plant Specific Exp	1,440	
	6532004	Plant Nonspecific Exp	348	
	6561000	Depreciation Exp	1,980	
	6611004	Customer Operations Exp	144	
	6623304	Customer Operations Exp	36	
	6728904	Corporate Operations Exp	660	
	7130000	Other Operating Income	768	
	7240900	Other Operating Taxes	120	
	7990000	Nonregulated Exp		5,676
	To reverse transfer of estimated Part 69 interstate expenses for WBI (Internet) to enable proper Part 36 allocation of total company expenses.			
14.	7220000	Federal Income Tax		28,296
	7230020	State Income Tax		57,396
	PPA		85,692	
	Adjust income taxes to remove prior period amounts and for adjustments to results.			

Arizona Telephone Company
Year 1 Estimated ICC Impact of FCC Order

Base Line of Eligible Recovery:

Interstate SWA (Includes LSS)	Total	5% Reduction	
Intrastate Terminating Access	610,396	(30,520)	Access Revenue Interstate
Recip Comp Revenue	279,114	(13,956)	Access Revenue Intrastate Access
Recip Comp Expense	102,501	(5,125)	Local Revenue Intrastate Local
Total Base of Eligible Recovery	(32,764)	1,638	Plant Non-Specific Intrastate Local
	959,247	(47,963)	
	AJE #8		

Arizona Telephone Company

Rate Base

As of June 30, 2012

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 21,239,025	\$ 9,729,997	\$ 11,509,028
Accumulated Depreciation	(17,669,810)	(8,393,883)	(9,275,927)
Net Plant in Service	\$ 3,569,215	\$ 1,336,114	\$ 2,233,101
Plant Under Construction	378,532	173,432	205,100
Material & Supplies	37,316	11,261	26,055
Deferred Income Taxes	(271,187)	(124,952)	(146,235)
Cash Working Capital	159,947	82,943	77,004
Rate Base	<u>\$ 3,873,823</u>	<u>\$ 1,478,798</u>	<u>\$ 2,395,025</u>

Arizona Telephone Company
For Twelve Ending June 30, 2012

CALCULATION OF CASH WORKING CAPITAL (CWC)

CASH OPERATING EXPENSES	Total Company	INTERSTATE	INTRASTATE
Total Operating Expenses	\$ 3,339,607	\$ 1,474,127	\$ 1,865,480
Less Depreciation & Amortization	1,225,514	578,743	646,771
Cash Operating Federal Income Taxes	(159,763)	82,638	(242,401)
Cash Operating State & Local Taxes	(34,199)	17,690	(51,889)
Total Cash Operating Expenses	\$ 1,920,131	\$ 995,712	\$ 924,419
% LAG (30 days)	8.33%	8.33%	8.33%
TOTAL CASH WORKING CAPITAL	<u>\$ 159,947</u>	<u>\$ 82,943</u>	<u>\$ 77,004</u>

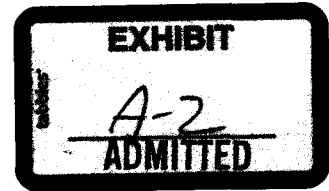
Arizona Telephone Company
Proposed Rate Design
2012 June Units

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Service Description	Jun-12 Units ^(a)	Current Rate ^(b)	Annual Revenues	Proposed Rates	Proposed Revenues	Proposed Change Revenue	Proposed Change Percent
Basic Service							
Residence One-Party	1,969	\$ 10.00	\$ 236,280	\$ 14.00	\$ 330,792	\$ 94,512	40.00%
Residence Four-Party	5	\$ 10.00	\$ 600	\$ 14.00	\$ 840	\$ 240	40.00%
Estimated Revenue from Local Rate Increase						\$ 94,752	

Notes:

- (a) No reduction made for line loss.
(b) Rate filed in pending docket #T-02063A-12-0302

Residential Lines												
Year	Type	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
2009	One-Party	2,898	2,888	2,872	2,865	2,858	2,922	2,927	2,849	2,785	2,718	2,602
2009	Four-Party	13	13	13	13	13	13	13	13	13	13	13
2009 Total		2,911	2,901	2,885	2,878	2,871	2,935	2,940	2,862	2,798	2,731	2,615
2010	One-Party	2,502	2,461	2,434	2,404	2,375	2,412	2,405	2,382	2,365	2,334	2,288
2010	Four-Party	11	11	11	11	11	11	10	10	10	10	7
2010 Total		2,513	2,472	2,445	2,415	2,386	2,423	2,415	2,392	2,375	2,344	2,295
2011	One-Party	2,195	2,177	2,167	2,154	2,146	2,178	2,169	2,159	2,154	2,125	2,069
2011	Four-Party	7	7	7	6	6	6	6	6	6	6	6
2011 Total		2,202	2,184	2,174	2,160	2,152	2,184	2,175	2,165	2,160	2,131	2,075
2012	One-Party	1,993	1,976	1,955	1,942	1,939	1,969					
2012	Four-Party	5	5	5	5	5	5					
2012 Total		1,998	1,981	1,960	1,947	1,944	1,974					



AZ Tel Cust Feb 2013

BUSINESS OFFICE NUMBER 6601
02-13-13
EXCHANGE NUMBER 0385
928-353-2271

BILLING DATE

ACCOUNT NUMBER

REGISTRATION ID
PAGE NUMBER

1 OF 4

03/05/13

Due Date

MICHAEL LARSEN

Total	Previous	Payments	Adjustments	Balance	Current
Amount	Balance Due	Thru 02/06/13	Thru 02/06/13		Charges
\$26.25	\$26.78 \$26.25	\$26.78CR	\$.00	\$.00	

THANK YOU FOR YOUR PROMPT PAYMENT.

SUMMARY OF CURRENT CHARGES	
LOCAL SERVICE	19.79
LONG DISTANCE	6.46
TOTAL CURRENT CHARGES	\$26.25
# DISCONNECTABLE TOTAL	20.45

03/05/13. Please pay total amount due. Subject to late payment fee after

FOR INQUIRIES SEE NUMBERS LISTED ON THE BACK OF THIS PAGE.

Please detach bottom portion and return with your payment.

♀

AZ Tel Cust Feb 2013
 BUSINESS OFFICE NUMBER 6601
 02-13-13
 EXCHANGE NUMBER 0385
 928-353-2271

BILLING DATE
 ACCOUNT NUMBER
 REGISTRATION ID
 PAGE NUMBER

2 OF 4

02-13-13 BILLING DATE
 928-353-2271 ACCOUNT NUMBER
 10-23-02 CONTROL DATE
 TDS TELECOM 660
 P.O. BOX 608
 LANCASTER WI 53813-0608
 Amount Late Fee Assessed Total Amount
 Enclosed After Due
 03/05/13 \$26.25

Make Check Payable To:

TDS TELECOM 660
 PO BOX 94510
 PALATINE IL 60094-4510
 MICHAEL LARSEN
 PO BOX 521
 PAGE AZ 86040-0521

♀

BUSINESS OFFICE NUMBER 6601 BILLING DATE
 02-13-13
 EXCHANGE NUMBER 0385 ACCOUNT NUMBER
 928-353-2271
 REGISTRATION ID
 PAGE NUMBER
 3 OF 4

PAYMENTS AND ADJUSTMENTS DETAIL

DATE	DESCRIPTION	AMOUNT
01-22	PAYMENT - THANK YOU	26.78CR

LOCAL SERVICE DETAIL

TO	QTY	DESCRIPTION	FROM
03-12-13	#	1ONE-PARTY RESIDENCE ACCESS LINE - BASE RATE AREA	02-13-13
02-13-13	#	1ARIZONA UNIVERSAL SERVICE FUND SURCHARGE	02-13-13
03-12-13	#	1FEDERAL SUBSCRIBER LINE CHARGE	02-13-13
03-12-13	#	1FEDERAL ACCESS RECOVERY CHARGE	02-13-13

AZ Tel Cust Feb 2013

02-13-13 1STATE 911 TAX
.20

02-13-13

FEDERAL EXCISE TAX
.55
FEDERAL UNIVERSAL SERVICE CHARGE
1.13
ARIZONA STATE SALES TAX
.66
COCONINO COUNTY TRANSACTION PRIVILEGE TAX
.11
TELECOMMUNICATION DEVICES FOR THE DEAF TAX
.11
ARIZONA CORPORATION COMMISSION TAX
.02

TOTAL LOCAL SERVICE
\$19.79

You are responsible for the Total Amount Due on your bill. However,
non-payment of any flagged charges may result in disconnection of your local service.

Your Primary Intralata Carrier is TDS

Your Primary Interlata Carrier is TDS

SUMMARY OF LONG DISTANCE CHARGES

TDS LONG DISTANCE
6.46

TOTAL SUMMARY OF LONG DISTANCE CHARGES
\$6.46

You are responsible for the Total Amount Due on your bill. However,
non-payment of any flagged charges may result in disconnection of your local service.

TDS LONG DISTANCE DETAIL

LONG DISTANCE CALLS

CARRA	ITEM	DATE	PLACE	CALLED	NUMBER	CALLED	TIME	MINUTES	RATE	CLASS	TYPE	CP
CARRB	ITS	SEQ		AMOUNT	TRANS							
	101-13		OGDEN	UT	801-621-2432		552PM	25:00	EVE	DIAL	DDD	CT
MZX	006777	119		5.00	B2006							
	201-19		PAGE	AZ	928-691-6381		1003AM	1:00	NGHT	DIAL	DDD	CT
MZX	010770	449		.20	B2000							
	301-23		PAGE	AZ	928-645-2505		456PM	2:00	DAY	DIAL	DDD	CT
MZX	013306	272		.40	B2000							

SUBTOTAL \$5.60

♀

BUSINESS OFFICE NUMBER 6601

BILLING DATE

02-13-13
EXCHANGE NUMBER
928-353-2271

AZ Tel Cust Feb 2013
0385

ACCOUNT NUMBER
REGISTRATION ID
PAGE NUMBER

4 OF 4

TDS LONG DISTANCE DETAIL - Continued
LONG DISTANCE CALLS - Continued

MZX : TDS

CARR-A: The long distance company who provided your service.

CT : TRUE TALK ADVANTAGE

TDS LD ADVANTAGE
02-13-13 TO 03-12-13 .00

FROM

TAXES

FEDERAL UNIVERSAL SERVICE CHARGE .81
ARIZONA STATE SALES TAX .04
COCONINO COUNTY TRANSACTION PRIVILEGE TAX .01

TOTAL TDS LONG DISTANCE DETAIL
\$6.46

ORIGINAL

MEMORANDUM
RECEIVED

2013 MAR 14 A 8:55

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

DATE: March 14, 2013

RE: IN THE MATTER OF THE APPLICATION OF ARIZONA TELEPHONE COMPANY FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, AND TO INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR THE RATE IMPACTS OF THE FCC'S USF/ICC TRANSFORMATION ORDER. (DOCKET NO. T-02063A-12-0473)

Attached is the Staff Report for Arizona Telephone Company's application to increase residential rates to compensate for the rate impacts of the Federal Communications Commission's Universal Service Fund/Intercarrier Compensation ("FCC's USF/ICC") Transformation Order.

Staff recommends approval of Arizona Telephone Company's request to increase its monthly residential local exchange service rate from \$10.00 to \$14.00, effective June 1, 2013.

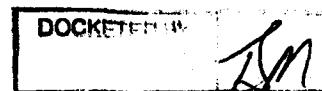
SMO:AFF:tdp\MAS

Originator: Armando Fimbres

Arizona Corporation Commission

DOCKETED

MAR 14 2013



SERVICE LIST FOR: ARIZONA TELEPHONE COMPANY
DOCKET NO.: T-02063A-12-0473

Mr. Craig A. Marks
CRAIG A. MARKS PLC
10645 N. Tatum Boulevard, Suite 200-676
Phoenix, Arizona 85028

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

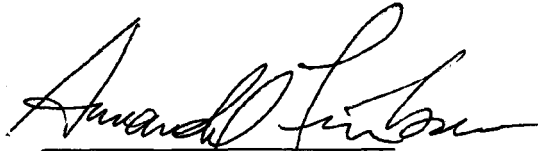
**ARIZONA TELEPHONE COMPANY
DOCKET NO. T-02063A-12-0473**

**IN THE MATTER OF THE APPLICATION OF ARIZONA TELEPHONE COMPANY
FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR
VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, AND TO INCREASE
RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR THE RATE
IMPACTS OF THE FCC'S USE/ICC TRANSFORMATION ORDER.**

MARCH 14, 2013

STAFF ACKNOWLEDGMENT

The Staff Report for Arizona Telephone Company (Docket No. T-02063A-12-0473) was the responsibility of the Staff member listed below.

A handwritten signature in black ink, appearing to read "Armando Fimbres", written over a horizontal line.

Armando Fimbres
Executive Consultant III

**EXECUTIVE SUMMARY OF
ARIZONA TELEPHONE COMPANY
DOCKET NO. T-02063A-12-0473**

On November 23, 2012, Arizona Telephone Company ("Arizona Telephone" or "Applicant") filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, Universal Service Fund/Intercarrier Compensation ("USF/ICC") Transformation Order ("USF/ICC Order") pursuant to Arizona Revised Statute ("A.R.S.") § 40-250 and the Arizona Corporation Commission's ("Commission's") Arizona Administrative Code ("A.A.C.") R14-2-103.

Staff recommends that the Arizona Telephone monthly residence local exchange rate increase from \$10.00 to \$14.00 to address the impact of the FCC's USF/ICC Order. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund ("FUSF") funds that may flow to Arizona Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increase; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
BACKGROUND	1
CONSUMER SERVICES	2
OPERATING INCOME STATEMENT	2
Operating Revenue and Expenses.....	3
Operating Income	3
RATE BASE.....	3
CUSTOMER BASE.....	4
REVENUE REQUIREMENT	4
RATE DESIGN	4
STAFF ANALYSIS.....	4
STAFF'S RECOMMENDATIONS	5

INTRODUCTION

On November 23, 2012, Arizona Telephone Company ("Arizona Telephone" or "Applicant") filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, Universal Service Fund/Intercarrier Compensation ("USF/ICC") Transformation Order ("USF/ICC Order") pursuant to Arizona Revised Statute ("A.R.S.") § 40-250 and the Arizona Corporation Commission's ("Commission's") Arizona Administrative Code ("A.A.C.") R14-2-103. A.A.C. R14-2-103(A)(1) requires specific financial and statistical information be filed with a request by a public service corporation doing business in Arizona for a determination of the value of the property of the corporation and of the rate of return earned. Arizona Telephone submitted, as recommended by Staff, a streamlined filing in which Arizona Telephone submitted the following six exhibits to support the requested increase in residential rates:

- Adjusted Results Twelve Months Ending June 30, 2012
- Adjustments
- Year 1 FCC Order ICC Impact
- Rate Base
- Working Capital
- Rate Design.

BACKGROUND

Arizona Telephone is a corporation duly organized and existing under and by virtue of the laws of the State of Arizona. Arizona Telephone is authorized to engage in and is engaged in the conduct of a general communications business within the State of Arizona. Arizona Telephone is a rate-of-return ("RoR") regulated incumbent local exchange carrier ("ILEC") serving non-metro communities.

On November 18, 2011, the FCC issued the USF/ICC Order. The USF/ICC Order transitions the outdated federal universal service programs and most intercarrier compensation systems into a new Connect America Fund ("CAF"). The FCC's press release characterized the USF/ICC Order as "the most significant policy step ever taken to connect all Americans to broadband."

In its USF/ICC Order, the FCC stated that it will reduce intercarrier compensation rates to zero by July 1, 2020, for RoR companies, with limited recovery from customers and partial recovery from the CAF. The recovery from the CAF will phase out over time at 5 percent annually. The USF/ICC Order adds new rules that will reduce federal high-cost loop support ("FHCLS") to carriers by the amount their flat-rate single line residential local service rates fall below a specified local service rate floor. The rate floor includes state subscriber line charges, state universal service fees, and mandatory extended area service charges, if any are assessed. The FCC's order establishes single line residential local service rate floors of \$10.00 as of June 1, 2012, \$14.00 as of June 1, 2013, with the floor thereafter being determined annually by the FCC's Wireline Competition Bureau, based on a nationwide average.

To maintain FHCLS, Arizona Telephone and other rural ILECs must increase single line residential local rates to the FCC-mandated residential rate floors. Otherwise, the amount of FHCLS funds will be reduced dollar-for-dollar for each customer by the difference between the existing single line local rate and the new rate floor. If single line local rates are not increased, the new FCC rules will reduce FHCLS for Arizona Telephone and other applicable ILECs.

The Commission last considered Arizona Telephone's rates in Docket No. T-02063A-12-0302, which resulted in Commission Decision No. 73575, dated November 21, 2012. Decision No. 73575, authorized Arizona Telephone residence rates to be raised to the rate floor of \$10.00. With this application, Arizona Telephone seeks Commission approval to raise its rates to the rate floor of \$14.00 by June 1, 2013.

CONSUMER SERVICES

On November 28, 2012, the Commission's Corporations Division responded that Arizona Telephone is in Good Standing. A review of Consumer Services database revealed that no complaints, inquiries and opinions were received pertaining to Arizona Telephone for the period January 1, 2009 thru November 28, 2012.

COMPLIANCE

A check of the Utilities Division Compliance Section database showed that Arizona Telephone is in compliance with all items.

OPERATING INCOME STATEMENT

Arizona Telephone submitted Adjusted Regulated Results of Operations for Twelve Months Ending June 30, 2012 information in its streamlined filing. The submitted information was accepted without adjustment for the purposes of this streamlined application.

Operating Revenue and Expenses

According to the information provided by the Applicant, Arizona Telephone Total Intrastate Operating Revenues for the Twelve Months Ending June 30, 2012 were \$1,121,018. Subcategories of Total Intrastate Operating Revenues are noted below:

Local	\$576,031
USF-HCL ¹ & Safety Net	\$106,060
Access Revenues	\$382,376
Other	\$56,551

The Company also stated that its Total Intrastate Operating Expenses for the Twelve Months Ending June 30, 2012 were \$1,865,480. Subcategories of Total Intrastate Operating Expenses are noted below:

Plant Expenses	\$576,037
Depreciation & Amortization	\$646,771
Customer Operations	\$240,375
Corporate Operations	\$331,093
Other	\$71,204

Operating Income

As provided by the Applicant, Arizona Telephone Total Intrastate Operating Income for the Twelve Months Ending June 30, 2012 was negative \$774,462 before taxes and negative \$460,172 after taxes.

RATE BASE

According to Arizona Telephone, its rate base is \$3,873,823, as stated in the table below:

Arizona Telephone Company

Rate Base

As of June 30, 2012

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 21,239,025	\$ 9,729,997	\$ 11,509,028
Accumulated Depreciation	(17,669,810)	(8,393,883)	(9,275,927)
Net Plant in Service	\$ 3,569,215	\$ 1,336,114	\$ 2,233,101
Plant Under Construction	378,532	173,432	205,100

¹ Universal Service Fund – High Cost Fund

Material & Supplies	37,316	11,261	26,055
Deferred Income Taxes	(271,187)	(124,952)	(146,235)
Cash Working Capital	159,947	82,943	77,004
Rate Base	\$ 3,873,823	\$ 1,478,798	\$ 2,395,025

CUSTOMER BASE

Arizona Telephone reported 2,036 residential lines and 770 business lines in its April 15, 2012 Utilities Annual Report.

REVENUE REQUIREMENT

As stated above, the Applicant's filing was based on a streamlined basis and rates will not be set based on rate of return regulation. Therefore, the Applicant's filing does not contemplate rate adjustments based on revenue requirement analysis.

RATE DESIGN

The Applicant did not propose a rate design as required by R14-2-103. The Applicant is seeking to increase its residential local exchange service rate by \$4.00. The Applicant's filing only contemplates changes to residence local exchange rates to compensate for the rate impacts of the FCC's USF/ICC order. With this filing, Staff will only address the monthly increase of all residence local exchange service rates to \$14.00.

STAFF ANALYSIS

Staff did not perform a regulatory audit of the information submitted by Arizona Telephone. However, Staff reviewed the information filed in the context of the FCC's November 18, 2011 USF/ICC Order which is intended to transition the outdated federal universal service programs and most intercarrier compensation systems into a new CAF.

Staff has analyzed this application in terms of whether there were fair value implications. For the purposes of this matter, the Applicant stipulated to the use of original cost less depreciation as the basis for a determination of its fair value rate base. The Applicant states that its intrastate rate base is \$2,395,025. The Applicant provided information that indicates that its Total Intrastate Operating Revenue for the Twelve Months Ending June 30, 2012 was \$1,121,018. According to the Applicant, the annual revenue effect of the increase in local telephone service rates to \$14.00 is \$94,752.² Compared to the Applicant's total revenues, any revenue impact from this rate increase would be small and any impact on the Applicant's fair

² Based on 1,974 one-party average residence lines.

value rate of return would be de minimus. Arizona Telephone's Operating Income would remain negative, therefore, the rate of return is not meaningful in this case, i.e., less than zero.

STAFF'S RECOMMENDATIONS

Staff recommends that the Arizona Telephone monthly residence local exchange rate increase from the residential local service rate of \$10.00 to \$14.00, beginning June 1, 2013, to address the impact of the FCC's USF/ICC Order. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the FUSF funds that may flow to Arizona Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increase; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff has reviewed the rate application and the federal rule changes that have prompted the rate application. Staff concludes that the costs appear reasonable and appropriate under the unique circumstances of this case. However, Staff's recommendation in these unique circumstances should not be viewed as precedent for the processing of future rate case applications.